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C O N F I D E N T I A L SECTION 01 OF 04 SAO PAULO 000130

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STATE FOR WHA/BSC,WHA/PDA AND INL
NSC FOR TOMASULO
SOUTHCOM ALSO FOR POLAD
USAID FOR LAC/AA

E.O. 12958: DECL: 03/14/2018
TAGS: ETRD PREL EINV ECON CH BR
SUBJECT: CHINA'S BUSINESS INTERESTS IN BRAZIL RECEIVE MIXED
REVIEWS

REF: 07 SAO PAULO 718

Classified By: Charge de Affairs James Story; reasons 1.4 (b) and (d).

Summary

¶1. (C) Although bilateral trade between China and Brazil continues to grow, there are increasing frustrations on both sides regarding access to each others' markets. For Brazilian business, China represents the largest opportunities for growth, but also the greatest economic risks, and many point to the first ever trade deficit with China, (USD 1.9 billion in 2007), as proof of these risks. Clearly, China plays a much more important economic role for Brazil than Brazil does for China. A recent conference regarding China-Brazil relations and subsequent conversations with Chinese business interests suggest an increasing wariness of this reality and of the PRC in general. Brazilian contacts state that China is not keeping its promise to import more from Brazil, and may in fact be making trade more difficult. In turn, Chinese businessmen in Brazil complain that corruption and bureaucracy are preventing greater investment in Brazil. To understand more fully the important and growing bilateral trade relationship, the Brazilian business and academic community is paying greater attention to the PRC's foreign policy and international trade movements. End Summary.

Bilateral Trade Expanding

¶2. (U) Trade relations between Brazil and China began to intensify in 2001 when China began seeking Brazil's natural resources to support its expanding economy and expanded

rapidly in 2004 when Brazil identified China as a market economy for the first time. The PRC then quickly became an important player for both Brazilian exports and imports; providing Brazil's second highest source of imports and third largest export destination last year. According to the Federation of Industries of Sao Paulo (FIESP), Brazilian exports to China rose from USD 1.9 billion in 2001 to USD 10.8 billion last year, and Chinese imports in Brazil went from USD 1.3 billion to USD 12.6 billion during the same period. While Brazilian exports to China continue to grow rapidly, Chinese exports to Brazil are growing at an even faster rate. Brazilian exports to China were up 28 percent from 2006; however, imports from China were up 57 percent. Until last year, Brazil had maintained a trade surplus (although declining in recent years) with China. In 2007, Brazil's appreciating currency combined with growing domestic consumption reversed the trade surplus of USD 500 million in 2006 to a deficit of USD 1.9 billion in 2007.

Trade Flows Concentrated

¶3. (SBU) Carlos Cavalcanti, FIESP's Senior Director for International Affairs, told Econoff that FIESP classifies the Brazil-China relationship as one of "master and colony" because Brazil exports mostly commodity products while China exports manufactured goods. Although China has become Brazil's second and fastest growing export market, 75 percent of these exports are concentrated in just five commodities: soy beans, iron ore, steel, soy oil, and wood. Similarly, 97 percent of Chinese imports in Brazil are manufactured products, mainly capital goods, machinery and equipment, and

other manufactured household goods. Cavalcanti indicated that in the long run, FIESP and other business organizations would need to work closely with the GOB to create a greater focus on exports of finished goods instead of just commodities.

Chinese Threat...Or Is It?

¶4. (SBU) Octavio de Barros, Director of Economic Research at Bradesco Bank, told Econoffs that China represents both the biggest opportunities and risks for Brazilian business. China offers an untapped resource of consumers and investment opportunities; however, cheaper Chinese labor and an artificially low currency make Chinese goods less expensive than their Brazilian equivalents. Brazilian industries in recent years had faced stiff Chinese competition. Julia Silveira, an economist with the Federation of Commerce of Sao Paulo (FECOMERCIO) told Econoff that China's lower production costs and higher utilization of technology in the production cycle make Chinese products less expensive than their Brazilian counterparts in the textile, footwear, furniture, and auto parts industries. Brazilian industries have countered Chinese imports by reducing their production costs (either by implementing new technology, moving production facilities to the Northeast where labor costs are lower, or making the production chain more efficient) to become more competitive against the influx of cheaper Chinese products. Miguel Holzbach, a footwear exporter in Brazil's southern state of Rio Grande do Sul, reported to Econoff that the industry has stabilized. Echoing Silveira's comments, Holzbach noted that several production facilities had relocated to Brazil's Northeast and that skilled laborers had also transferred to China to train the Chinese labor force.

Bilateral Relationship

¶5. (SBU) During a FIESP-sponsored seminar entitled "China: Challenges and Opportunities," several renowned academics and retired policymakers discussed the future of bilateral

relations between the PRC and Brazil. Ambassador Sergio Amaral, Coordinator of FIESP's Superior Council and former Minister of Development, Industry, and Commerce, stated that Brazil's fascination with China continues to grow among political decision-makers, business leaders, and scholars. He noted that nearly every week Brazilian China specialists or visitors from China participate in seminars, talks, or speeches regarding China-Brazil relations. According to Amaral, one of the principal areas of interest in Brazil is whether the U.S.-Soviet rivalry of the Cold War will morph into a U.S.-PRC phenomenon and what impact this new tension would have on Brazil.

¶6. (SBU) Rubens Barbosa, former Brazilian Ambassador to the U.S. and current President of the FIESP Superior Council on Foreign Trade, claimed that while political relations between Beijing and Brasilia are "excellent", characterized by frequent high-level visits from both sides, there is a strong sentiment of disappointment in bilateral trade. According to Barbosa, Brazilian officials and business leaders believed that Brasilia's 2004 recognition of China as a market economy would lead to booming trade between the two countries. Recalling that FIESP lobbied strongly against granting China market economy status, Barbosa noted that there is now increasing concern that Brazilian jobs will migrate to China

where labor is cheaper. Already several major businesses have opened up factories in China, and this may be the beginning of a trend mirroring the experience of many U.S. companies that have moved their operations to China, Barbosa said.

Access to the Chinese Market

¶7. (U) George Washington University International Relations Professor - and one of the world's leading academic experts on the PRC - Harry Harding said that Brazilian analysts are starting to grow wary of China's rocketing international commercial standing. The PRC, which initially welcomed foreign investment following Deng Xiaoping's opening-up policies, is beginning to show increasing signs of protectionism, Harding stated. While Brazilians are enthusiastic that China is a vast consumer of Brazil's raw materials, the PRC's support for "national champion" firms is increasingly closing off opportunities to Brazilian business interests. According to Harding, in order to prop up these growing companies and encourage their growth against non-PRC competitors, Beijing gives them tax incentives and access to inexpensive capital, and lobbies and advocates vigorously on their behalf during official visits. (Comment: While the methodology for supporting national firms in China may be different from the Brazilian experience, analysts have historically considered Brazil's economy "closed" to imports in an attempt to support domestic industry. These import duties are one of the most onerous barriers to entry in Brazil for many industrial goods. End Comment.)

Chinese Concerns about Brazilian Market

¶8. (C) Chinese businessmen also highlighted the difficulties they face in operating in Brazil. SVA da Amazonia, Ltd. Director General Martin Wang (please protect), head of a major seller of electronics and digital products, told Poloff that opening a company in Brazil requires pay-offs to Brazilian customs and trade officials, as well as paying buyers under the table for initial contracts and follow-on purchases. Gree Electric Appliances of Brazil Director General Yue Haiping (please protect) said that bureaucratic hurdles prevent small foreign businesses from opening in Brazil. Yue said that his company, a major international air conditioning firm, needed a whole team of lawyers and specialists to break down the barriers of Brazil's government entities involved in approving all the licenses to operate in

Brazil. Tang Wei (please protect), an attorney specializing in helping PRC firms launch in Brazil, said that Brazil's myriad of regulations and legal codes discourage Chinese investment in Brazil. (Comment: The World Bank report Doing Business in Brazil corroborates these claims. Their 2008 report shows that Brazil ranked 122 out of 178 countries for overall ease of doing business. It takes an average of 152 days to open a business and 411 days to build a warehouse (including obtaining licenses). End Comment.)

¶9. (SBU) Indeed, Brazilian firms have invested more money into China than Chinese firms have put into the Brazilian private sector. Pedro Pedrossian, Manager of FIESP's International Relations, Foreign Trade, and Trade Remedies Department, told Econoff that Brazilian investments span several industries including energy and mining (Petrobras, Vale do Rio Doce, Coteminas), aviation (Embraer), banking (Itau and Banco do Brasil), and the footwear and textiles

industries. However, Pedrossian said that Chinese investments were limited to ethanol, lumber, and more recently steel industries. He underscored that Chinese investments were aimed at exporting production to China while Brazilian investments in China were designed to gain access to the Chinese domestic market.

Comment

¶10. (C) Business between China and Brazil is continuing to grow (ref), but neither the Chinese nor Brazilians seem to believe that it is achieving its potential. Clearly, Brazil cannot ignore the Chinese market opportunities as well as the competition Chinese businesses represent. Bilateral trade will continue to grow in volume and value in the coming years, even though Brazilian views on business links with China are mixed. While it is evident that there are some sectors who view booming trade with China as a positive, there are some Brazilian businesses who continue to see China's economic growth as a possible threat. Brazil will need to reassess its own trade policy and decide whether it will continue to focus heavily on selling commodities overseas or shift towards a more PRC-like export plan centering on industrial and finished goods. The Brazilian business community seems to understand that the PRC's trade policies, while cutthroat in appearance, are business as usual for many nations. More importantly, these organizations understand the need to work with the government on the regulatory framework and public policies that will shift Brazil's export focus, with China as well as the rest of the world, towards value-added manufactured goods. End Comment.

¶11. (U) This cable was coordinated with and cleared by Embassy Brasilia.
STORY